2

FIAT MONEY AND THE GOLD STANDARD

Confidence and Money

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In Ohio and Maryland, state-run savings and loan insurance schemes failed when depositors asked for their money. The crises came to an end, at least on the surface, with coverage from the Federal Savings and Loan Insurance Corporation.

The FSLIC was seen as a cure, not because of its assets—they cover less than .8% of deposits—but because of the Federal Reserve's implicit promise to print enough dollars to cover any FSLIC (or Federal Deposit Insurance Corporation) crisis. To stop just the Continental Illinois bank run, the Fed created $3.5 billion to avoid draining the FDIC, which has assets covering less than .8% of deposits.

The S&L industry is shakier than ever before, thanks in part to real-estate and junk-bond speculation. The city of Washington, D.C., for example, has seven federally insured S&Ls. Only two meet the FSLIC's minimal requirement of a net worth equal to 3% of liabilities—and this is calculated using very liberal accounting standards. When you apply slightly stricter ones, two of the seven have a negative net worth.

This is true despite FSLIC gimmicks—such as "net-worth certificates"—designed to paper over S&L problems. Subtract these, and rate old mortgages at the market rather than the face value, and virtually the entire industry would be technically bankrupt.

"Technically" is the key word, however, because so long as the Fed stands ready to make cheap loans through the discount window—a subsidy S&Ls now share with banks—and to bail out the FSLIC, the industry will be kept afloat. (The value of the dollar will be another matter, however.)

In Ohio and Maryland, loss of confidence was blamed for the runs on the S&Ls. That is, depositors—after reading about fraud involving one state-insured institution—worried that their money might be at risk in all of them, and sought to withdraw it.

It's hard to imagine a similar problem in any other business. The computer industry, for example, couldn't go out of existence overnight because of fraud at one company causing a "loss of confidence." Of course, IBM doesn't pledge to have customers' property available on demand, while at the same time loaning it to others.

The dollar itself, thanks to the Fed, also depends on confidence, and as with the S&Ls, this can be lost overnight when the monetary and fiscal chickens come home to roost.

Justifiable confidence in the dollar, the S&Ls, and the banks will only come with a gold standard, and with savings and lending institutions built upon it: ones that would not—in the absence of federal subsidies—go belly up upon being asked to keep their word.